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by

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The cases discussed below are those issued by California courts and federal courts that have jurisdiction over California and which may be of interest to attorneys drafting contracts that have arbitration clauses within them.

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Abramson v. Juniper Networks, Inc., 115 Cal App 4th 638 (Sixth Appellate District 2/6/2004). **UnconscionabilitySophisticated Employee**. An arbitration clause in an employment contract with an employee who had admittedly been able to negotiate the other terms of the contract and who allegedly was "a person of renown" was nevertheless found to be unconscionable. The clause was found to be procedurally unconscionable because the employee's claim that it was non-negotiable was corroborated by a provision requiring his acknowledgment that he was "offered employment in consideration of his promise to arbitrate". The clause was substantively unconscionable because it required the employee to pay one half of the costs of arbitration and because it contained a carve out which permitted the employer to go to court to enforce a misuse of trade secrets claim. Although the carve out nominally granted "both parties" the right to seek judicial relief, a closer examination demonstrated that it lacked mutuality for several reasons. First, the arbitration clause stated that it constituted a waiver of the *employee's* right to a jury trial. Second, the carve out stated that it existed because it would be impossible to measure *the Company's* damages from a breach of the covenant to protect intellectual property. Third, with respect to the carve out, the employee agreed that "if *I breach*" the covenant, then both parties would have the right to obtain specified judicial remedies. Because there were two substantially unconscionable provisions, the offensive clauses were not found to be severable.

Comment. In this case, the arbitration clause was probably non-negotiable. However, in many cases where parties negotiate the substantive terms of a contract, the arbitration

clause as presented by one party is not negotiated because it is considered to be boiler plate. This case underscores the need for the parties to create a record that would indicate that the arbitration clause was negotiable, even if it was in fact not negotiated. This is particularly important in an employment contract with a senior executive where the employer needs a carve out to seek judicial relief for a misuse of trade secrets or to enforce an otherwise valid covenant not to compete. If in fact the court finds that the arbitration clause was negotiable, notwithstanding that the party opposing arbitration failed to take advantage of this right, the court might find no procedural unconscionability. In such event, the carve outs will be upheld because there must be both procedural and substantive unconscionability in order for a contract to be declared to be unconscionable.

Azteca Construction, Inc. v ADR Consulting, Inc., 121 Cal App 4th 1156 (Third Appellate District 8/25/2004). Disclosure**Statute Requiring Disqualification of Arbitrators Based on Disclosure Trumps Contractual Provision on Disqualification.** Code of Civil Procedure Section 1281.9, which requires the disqualification of an arbitrator if one party objects to the arbitrator within 15 days after the arbitrator makes the required conflicts disclosure trumps a contractual provision that the procedure for disclosure is based on the rules of the American Arbitration Association ("AAA"). AAA Rule R-20(b) gives the AAA the final authority to rule on disqualification. In this case, the AAA determined that the matters revealed by the arbitrator were not sufficient to require his disqualification. After the arbitrator issued an award adverse to the objecting party, it moved to vacate the award, as was its right if Section 1281.9 applied. The trial court denied the motion, holding that the objector had waived its rights under Section 1281.9 because it had agreed to the AAA rules. On appeal, the decision was reversed. There could not be a waiver for three reasons. First, the statute was enacted primarily for a public purpose because it was intended to "protect participants in arbitration" and to "promote public confidence in the arbitration process". Second, there is a fundamental difference between contractual and statutory rights. While parties may be free to contract among themselves for alternative ways of dispute resolution, such contracts would be valueless without the state's blessing. The state retains ultimate control over the "structural aspects of the arbitration process" and the critical subject of arbitrator neutrality is a structural aspect of the arbitration and falls within the Legislature's supreme authority. Finally, the neutrality of the arbitrator is of such critical importance that the Legislature cannot have intended that is regulation be delegated to the unfettered discretion of a private business.

Balandran v. Labor Ready, Inc., 124 Cal App 4th 1522 (Second Appellate District 12/17/2004). Agreement to Arbitrate**Employment Agreement**Events Occurring Prior or Subsequent to Employment-**Defendant was a service which employed temporary workers to work for third parties. It required all workers to sign an application agreeing that they were only employed during periods that they were assigned to a job. The application also had a provision whereby the applicants agreed to arbitrate all disputes "arising out of my employment, including any claims of discrimination *** that I believe I have against Labor Ready and all other employment related issues (excluding only claims arising under the National Labor Relations Act ***)". Plaintiffs

filed suit alleging gender discrimination, because defendant allegedly agreed with a third party employer that it would not refer women for a particular job. Defendant's motion to compel arbitration was denied because plaintiffs were not assigned to a job when the discrimination occurred and hence the claim did not arise out of their employment. Defendant's argument that the phrase "all other employment issues" made the dispute arbitrable was rejected for two reasons. First, without a comma between "Labor Ready" and "all other employment related issues", there was no reason to believe that "all other employment related issues" was not part of the "including" clause. Second, if "all other employment related issues" was to be a second, separate category of arbitrable disputes, the parenthetical clause would only apply to the second category. Clearly, defendant did not intend to exclude from arbitration only NLRA claims that are "other employment related issues", but not those "arising out of employment".
Comment. Disputes with employees or potential employees that occur before hiring or after termination have been held to be arbitrable where the contract was drafted carefully enough to include those disputes. For example, claims by applicants who were not hired, allegedly because of discriminatory practices, have been held to be arbitrable, as have claims that arise out of post termination events, such as defamation. Defendant here could have avoided this result if the contract was written in such manner that it covered employment related events that occurred prior to hiring or post termination.

Buckhorn v. St. Jude Heritage Medical Group, 121 Cal App 4th 1401 (Fourth Appellate District 8/31/2004). Agreement to Arbitrate**Post Employment Torts.** A contract in an employment agreement which provided for arbitration of disputes "concerning the enforcement and interpretation of any provisions of this agreement" covered claims for defamation and interference with prospective economic advantage that occurred after the employee, a physician, was terminated. Determination of whether the arbitration clause covered these events turned on whether the tort claims were "rooted" in the contractual relationship between the parties, not when they occurred. For example, plaintiff's claim of interference with prospective economic advantage was based on an expectation of future income from plaintiff's patients. But plaintiff's patients consulted him in his capacity as an employee of the defendant, hence there was coverage.

Crippen v. Central Valley RV Outlet, Inc., 124 Cal App 4th 1159 (Fifth Appellate District 12/10/2004). *UnconscionabilityConsumer Contracts.** An arbitration provision in a contract to purchase a recreational vehicle was not found to be unconscionable even though it prohibited the purchaser from filing or participating in a class action and gave an option to the vendor, but not the customer, to file suit in court. In order to find unconscionability, there must be both procedural and substantive unconscionability, although not necessarily to the same degree. Here, the purchaser failed to present any evidence of procedural unconscionability. He did not provide the court with any reason to suppose that substantially unequal bargaining power was inherent in the relationship. The arbitration provision was not set in small type and in fact was on a separate page that was signed by the purchaser. There was no reason to conclude that plaintiff lacked the power to bargain and, in general, nothing prevents purchasers of used vehicles from bargaining with dealers, even where the dealers present the purchasers with form contracts.

Comment. Plaintiff argued that the court could infer unequal bargaining power from the form of the contract. But the court refused to apply this theory to a situation where the plaintiff was a consumer and not required to purchase the item that was for sale. This is different from an employment contract where an employee may feel severe economic pressure to sign the agreement because he or she does not want to lose the job. The court also distinguished this case from *Harper v Ultimo,* 113 Cal App 4th 1402, which did involve a consumer contract. In that case, arbitration was to be conducted pursuant to the rules of the Better Business Bureau, but the vendor failed to attach the rules, which substantially limited the buyer's rights, to the contract and the contract failed to state whether the Better Business Rules rules in effect at the time of signing or at the time of arbitration would control, thereby causing the customer to blindly sign on to a costly preliminary dispute over what rules would apply if there was a conflict.

Dream Theater, Inc. v. Dream Theater, 124 Cal App 4th 547 (Second Appellate District 11/30/04) Contract Interpretation**Effect of Use of the Word 'Indemnify'**Effect of Venue Clause**-The contract involving the sale of a business in this case had an extensive dispute resolution clause. The clause provided for arbitration and stated that each party would "indemnify" the other for any breach of the representations and warranties in the contract. Following a dispute with the buyer, the seller filed suit in state court. It argued that the dispute was not arbitrable because the arbitration clause only covered agreements to indemnify, i.e., third party claims. Plaintiff further supported its position by noting that the agreement also provided that any action arising out of the agreement could be brought in state or federal court in Los Angeles. The court rejected plaintiff's argument. Indemnification agreements ordinarily relate to third party claims. But this general rule does not apply if the parties to a contract use the term "indemnity" to include direct liability as well as third party claims. Here, the contract stated that each party was to indemnify the other for losses "whether or not arising out of third party claims". The venue clause does not negate the arbitration clause. No matter how broad the arbitration clause, it may be necessary to file an action in court to enforce an arbitration agreement, or to obtain a judgment enforcing an arbitration award, and the parties may need to invoke the jurisdiction of a court to obtain other remedies, such as a preliminary injunction, appointment of a receiver, or a writ of attachment or possession.

Fair v. Bakhtiari, 122 Cal App 4th 1457 (First Appellate District 10/12/2004)-Mediation Settlement Agreement Enforceability**Arbitration Clause Contained Therein.** A settlement agreement that is entered into during the course of a mediation is nevertheless subject to the confidentiality provisions of Section 1119 of the Evidence Code and thus ordinarily would not be admissible in court or otherwise enforceable. However, Section 1123 of the Evidence Code provides that such an agreement is not made inadmissible or protected from disclosure by Section 1119 if the agreement provides that it is "…admissible or subject to disclosure…..or enforceable or binding or words to that effect". In this case, the parties entered into a settlement agreement at the conclusion of a mediation which did not contain the words "enforceable" or "subject to disclosure" or "admissible" or "binding" but did provide that "any and all disputes

subject to JAMS arbitration rules". This latter phrase contained "words to th(e) effect" that the parties intended the agreement to be binding because the parties must have contemplated that an arbitrator would, in the event of any disputes related to the settlement agreement, consider and resolve such disputes.

Comment. The settlement agreement in this case was handwritten and, like most settlement agreements entered into at the conclusion of a mediation, contemplated a final and more detailed agreement at a later date. Hence, it was really an interim settlement agreement. Notwithstanding the result here, it would be better practice to incorporate the language set forth in Section 1123 when drafting interim settlement agreements at the close of a mediation.

Fitz v NCR Corp., 118 Cal App 4th 702 (Fourth Appellate District 4/27/2004). **UnconscionabilityDiscovery Restrictions**Lack of Mutuality.** The employer in this employment discrimination case attempted to avoid the issue of lack of mutuality by providing that a discovery limit of two depositions would be applicable to both sides. But the court nevertheless found the provision to be substantively unconscionable because "the employer already has in its possession many of the documents relevant to an employment discrimination case as well as having in its employ many of the relevant witnesses". Although the contract permitted the arbitrator to broaden the discovery limitation, the arbitrator was severely constrained from doing so because the limit could only be breached if the aggrieved party could demonstrate that that a fair hearing would be *impossible* without additional discovery. Arbitration was to be conducted before the AAA and the employer argued that the discovery limitation was nugatory because, subsequent to the adoption of the employer's arbitration policy, the AAA instituted broader discovery provisions in its rules and it required the arbitrator to apply the AAA rules if an inconsistency existed between the arbitration agreement and AAA rules. But the court dismissed this argument because there was no assurance that an arbitrator would find an inconsistency and the employer should not be "relieved of the effect of an unlawful provision it inserted in the arbitration provision because of the serendipity that the AAA rules changed since the employment contract was executed". There was also a lack of mutuality even though the contract allowed both parties to seek judicial relief in matters involving misuse of trade secrets and covenants not to compete because these were claims that the employer, not the employee, was more likely to bring.

Comment. The procedural unconscionability leg was met because the employer's arbitration policy was enunciated in a brochure that it distributed to the employees which they could not negotiate and which they did not sign. This is a common way of establishing or amending an arbitration policy, but it will be upheld if the procedures in the policy are not substantively unconscionable. With respect to the carve out, the employer may have avoided substantive unconscionability by allowing both parties the right to file injunctions in court, provided that the underlying dispute was arbitrated.

Frei v. Davey, 2004 Cal App LEXIS 2167 (Fourth Appellate District, 12/17/2004). **MediationCondition Precedent to Recovery of Attorney Fees.** The standard form residential purchase agreement used in California now has a clause requiring that a

prevailing party in litigation who refused a request to mediate made before the commencement of proceedings is barred from recovering attorney fees. Defendant, who prevailed in this action, attempted to avoid this provision on several grounds. He argued that the clause was inoperable because it did not provide for a time within which a response to the demand for mediation must be made, but the court concluded that in the absence of a specific time, a reasonable time was appropriate. Defendant also argued that mediation would have been ineffective because the parties had had settlement discussions which had proved not to be fruitful. But the court held that communications between the parties or their counsel regarding settlement are not the same as mediation. In mediation, a neutral third party analyzes the strengths and weaknesses of each party's case, works through the economics of litigation with the parties, and otherwise assists in attempting to reach a compromise resolution of the dispute. Defendant also claimed that he did not refuse to mediate because a mediation (unsuccessful) was conducted just before trial, 22 months after defendant initially rejected the demand for mediation. But the court held that a refusal to mediate could not be cured more than one year later. The purpose of the early mediation requirement was to minimize the costs of litigation. To allow a party to wait one year until the eve of trial to accede to a request for mediation would defeat that purpose. When a contract conditions the recovery of attorney fees on a party's willingness to participate in mediation before the litigation begins, the window for agreeing to mediate does not remain open indefinitely.

Comment. The court noted that this was a textbook example of why agreements for attorney fees conditioned on participation in mediation should be enforced. The parties were only $18,540 apart during settlement negotiations and ultimately spent over $500,000 in attorney fees in a matter which ended without the property changing hands.

Garcia v. DirecTV, Inc., 115 Cal App 4th 297 (Second Appellate District, 1/28/2004) Class Wide Arbitration**Agreement Silent**Who Decides.** After plaintiff filed a class action against defendant, the latter moved to compel arbitration of plaintiff's individual claim. The underlying arbitration agreement was silent with respect to whether parties thereto could file class actions. The lower court held that it (not the arbitrator) would determine the class action issues including the threshold issue about whether arbitration was prohibited by the terms of the agreement. It then found that class wide arbitration was permitted. The court's decision with respect to who decides these issues was contrary to the decision by the United States Supreme Court in *Green Tree Financial Corp. v. Bazzle,* 539 US 444, 123 S.Ct 2402 (2003). Defendant appealed, arguing that *Green Tree* required a reversal. The plaintiff argued that this case was different from *Green Tree* because the arbitration agreement stated that the arbitrator did not "have the power to commit errors of law or legal reasoning" and, ergo, legal issues needed to be decided by the court. But the appellate court disagreed and reversed. The mandate to the arbitrator to decide the case without committing errors of law or legal reasoning plainly contemplated judicial review of the arbitrator's decisions, not judicial advice about how such decisions should be made.

Comment. In theory, DirecTV could avoided this part of the dispute by providing in the arbitration agreement that class wide arbitration was prohibited, as was the case in

Crippen, supra. But now is not the time for a business to insert such a clause in its standard arbitration agreements because this very issue is before the Supreme Court in connection with the appeal of the decision in *Discover Bank v. Superior Court,* 105 Cal App 4th 326 (2003). In that case, the appellate court held that such a clause was permissible. But in *Szetela v. Discover Bank,* 97 Cal App 4th 1094 (2002), another appellate court held that such a provision was unconscionable in an adhesion contract and refused to enforce it.

Goliger v. AMS Properties, Inc., 123 Cal App 4th 374 (Second Appellate District, 10/21/2004) Agent Executing Agreement.** Plaintiff brought a wrongful death suit against defendant, operator of a nursing home, arising out of the death of her mother. She sued in her individual capacity and as her mother's personal representative. When plaintiff's mother entered the nursing home, plaintiff was presented with an arbitration agreement. It had three signature lines—for resident (plaintiff's mother), responsible party, and agent. Plaintiff signed as "responsible party", but the other two signature lines were left blank. Defendant's motion to compel arbitration on the basis of this agreement was denied. Defendant argued that it had reason to rely on the premise that plaintiff was her mother's agent, even though she did not sign the agreement as agent, because she made or affirmed the decisions regarding her mother's health care. But decisions by an agent regarding health care do not equate with being an agent empowered to waive the constitutional right of trial by jury. Plaintiff did not have to arbitrate her personal claim because there was no record of her signing the agreement in her personal capacity. The fact that she signed as responsible party only meant that she had agreed to pay the bills rendered by defendant to her mother.

Comment. This case illustrates the fact that the waiver of the constitutional right to a trial by jury by an agent is much different from other acts of agency. If an agent signs an agreement to arbitrate, it would be good practice to append to the agreement a document executed by the principal authorizing the agent to so act.

Hedges v. Carrigan, 117 Cal App 4th 578 (Second Appellate District, 4/6/2004) Real Estate Contracts**Bold Face Requirement**Preemption by FAA**. Code of Civil Procedure Section 1298 provides that an arbitration clause in a real estate contract is enforceable only if it is in eight point bold type, headed by the phrase "Arbitration of Disputes" and containing a warning that certain rights attendant to judicial proceeding are being lost by initialing the agreement to arbitrate. The contract in this case did not meet the requirements of Section 1298, but the court found that Section 1298 is preempted by Section 2 of the Federal Arbitration Act ("FAA") because Section 1298 only applies to arbitration contracts. The FAA makes unlawful any state policy that places arbitration contracts on an unequal footing with other contracts. States cannot decide that a contract is fair enough to enforce its basic terms but not fair enough to enforce its arbitration clause. Preemption of course applies only in the case of an arbitration clause in "a contract evidencing a transaction involving interstate commerce". The United States Supreme Court has interpreted the term "involving commerce" as the functional equivalent of the term "affecting commerce"---words of art that ordinarily signal the broadest permissible exercise of the commerce clause. Here, the court found a

connection with interstate commerce, admittedly "not as strong as in others", because the plaintiffs' mortgage was financed by the Federal Housing Administration and the various copyrighted forms used by the parties could only be utilized by members of the National Association of Realtors.

Nyulassy v. Lockheed Martin Corp., 120 Cal App 4th 1267 (Sixth Appellate District 7/27/2004). **UnconscionabilityEmployee Represented by an Attorney.** The fact that an employee who executed a mandatory employment agreement retained an attorney who was able to amend the at will clause in the contract so that the employee could only be terminated for good cause during the first three years of employment did not save the arbitration clause in the contract from being deemed to be unconscionable. The arbitration clause provided that only the employee was required to arbitrate and that he had to commence the arbitration within 180 days of the event or within 180 days of termination, no matter what the term of the statute of limitations. Although the presence of the attorney reduced the degree of procedural unconscionability, it did not affect substantive unconscionability because the arbitration provision in the agreement was non-negotiable. The contract also provided for a dispute resolution process whereby the employee had to submit to counseling and mediation with a company representative as a condition precedent to filing the arbitration. Although procedures of this nature are often laudable, the Court found that, given the unilateral nature of the arbitration provision, the procedure gave a "free peek" at the employee's case, thereby giving it an advantage if and when the employee chose to arbitrate.

Saeta v. Superior Court, 117 Cal App 4th 261 (Second Appellate District 3/30/2004). **Definition of Arbitration or MediationEmployee Termination Procedure.** The employer in this matter utilized a procedure whereby terminated employees could voluntarily request a review by a board of three people who would make a recommendation to management whether the termination should or should not be upheld. The review board would consist of two employees, one each appointed by the employer and employee, and a third party neutral chosen by the two appointed board members. A terminated employee took advantage of this procedure, and after the review board recommended to management that the termination be upheld, the employee filed suit and sought to depose the third party neutral. The neutral moved to quash his testimony on the ground that the proceeding was an arbitration or mediation and that he was thus incompetent to testify pursuant to Evidence Code Sections 703.5 and 1119. The court found that the proceeding was neither an arbitration nor a mediation. An arbitration is a process of dispute resolution in which a neutral third party renders a decision after a hearing at which both parties have an opportunity to be heard. Here there was no third party decision maker. The review board merely submitted its recommendation to management, which was not bound to accept it. Furthermore, neither the employee nor the employer sought to confirm the recommendation under Code of Civil Procedure Section 1285. A mediation is a process where a neutral third party who has no authoritative decision making power intervenes in a dispute to assist the disputing parties in voluntarily reaching their own mutually acceptable agreement. The concept of self

determination, which gives the parties control over the resolution of the dispute, is of major importance to the mediation process. There was no self determination in this case.

Comment. Many employers have procedures which allow employees to air grievances that either occur in the course of employment or develop from termination. This case illustrates the fact that this process is often subject to discovery in subsequent litigation. However, there is a possibility that such an outcome can be avoided. In *Garstang v. Superior Court,* 39 Cal App 4th 526 (1995), communications disclosed during sessions with an ombudsperson were held to be protected by the participants' right of privacy contained in the California Constitution. That privilege is qualified and must be balanced against a compelling and opposing state interest in obtaining the truth through discovery. The right of privacy outweighed the state interest in *Garstang* because the employer had pledged to all of its employees that communications with the ombudsperson would be confidential

Yuen v. Superior Court, 121 Cal App 4th 1133 (Second Appellate District 8/25/2004). ****Consolidation**Who Decides.** Under the rationale of *Green Tree v. Bazzle,* 539 US 444 (2003), a decision by the trial court to consolidate two separate arbitrations was reversed and the matter was referred to the arbitrator for decision. A court decides whether a matter should be referred to arbitration, but once a matter is referred to arbitration, the court's involvement is strictly limited until the arbitration is completed. Here, the contract provided that "all disputes" relating to the contract should be submitted to arbitration. Hence, *Green Tree* mandates that consolidation is such an issue. *Comment.* Assuming that a party decides that it is in its best interest to avoid consolidation or that it would prefer to have the decision rendered by a court, this result could have been avoided if the contract prohibited consolidation or provided that the issue of consolidation could only be decided by a court.